

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

KARL FILLIP,	)	
	)	
Plaintiff,	)	
	)	
v.	)	C.A. No. 8712-ML
	)	
CENTERSTONE LINEN	)	
SERVICES, LLC,	)	
	)	
Defendant.	)	

MASTER’S REPORT

(Defendant’s Motion to Dismiss and Plaintiff’s Motion for Summary Judgment)

Date Submitted: October 1, 2013

Final Report: December 3, 2013

Stephen E. Jenkins, Esquire and Marie M. Degnan, Esquire of ASHBY & GEDDES, Wilmington, Delaware; OF COUNSEL: Phillip S. McKinney, Esquire and John K. Larkins III, Esquire of ROGERS & HARDIN LLP, Atlanta, Georgia; Attorneys for Plaintiff.

William M. Lafferty, Esquire and John P. DiTomo, Esquire of MORRIS, NICHOLS, ARSHT & TUNNELL LLP, Wilmington, Delaware; OF COUNSEL: Michael W. Johnston, Esquire, Samuel M. Matchett, Esquire and Darrick L. McDuffie, Esquire of KING & SPALDING LLP, Atlanta, Georgia; Attorneys for Defendant.

LEGROW, Master

This dispute is standard fare in the world of indemnification and advancement. The plaintiff, Karl Phillip (“Phillip”), is a member, manager, and the former CEO of defendant Centerstone Linen Services, LLC (“Centerstone” or the “Company”). In 2012, Phillip resigned his position as CEO and then filed a lawsuit in Georgia when Centerstone refused to pay Phillip the severance to which he believed he was entitled. Centerstone quickly alleged counterclaims and affirmative defenses against Phillip in the Georgia case, alleging he breached his fiduciary duties and certain contractual obligations by manipulating the Company’s earnings and revenues, paying kickbacks, modifying the terms of a note obligation between the Company and Phillip’s holding company, and attempting to sell Centerstone without the board of managers’ authorization. When Phillip demanded Centerstone advance his attorneys’ fees and expenses related to the affirmative defenses and counterclaims, Centerstone sought to avoid its advancement obligations by filing amended counterclaims omitting the counts alleging Phillip breached his fiduciary duties. Centerstone argued Phillip was not entitled to advancement for the remaining counts because those claims were personal to Phillip and did not involve actions he took in the performance of his duties as CEO. This lawsuit soon followed.

Centerstone is not the first company to experience the uncomfortable remorse of having granted advancement rights to an official the company now believes engaged in grievous misconduct, nor is it the first to attempt to evade its contractual advancement obligations by offering an awkward or illogical interpretation of the advancement obligation or the underlying litigation. Those arguments rarely succeed, and they meet no different fate in this case. The only reasonable reading of the language at issue leads

to the conclusion that Phillip is entitled to advancement for at least two of the three counterclaims asserted by Centerstone, as well as the dismissed counterclaims and the affirmative defenses that relate to his alleged wrongdoing as CEO.

## **BACKGROUND**

The background facts largely are undisputed. Not surprisingly, the parties vigorously dispute the facts underlying the claims pending in Georgia, but those disputes are not relevant to the resolution of Phillip's advancement rights. The parties agree this case can be resolved on the record currently before the Court.<sup>1</sup>

### **A. The parties and the formation of Centerstone**

Centerstone is a Delaware limited liability company with its principal place of business in Georgia. Centerstone provides healthcare linen services through its wholly owned subsidiaries, Alliance Laundry and Textile Services ("Alliance") and Atlas Healthcare Linen Services. Phillip and his business partner founded Alliance in 1999, and Phillip served as Alliance's President and CEO until 2008, when Phillip and his partner sold Alliance to Centerstone. In connection with that sale, Phillip received a 10.47% Class A preferred membership interest in Centerstone, which he holds through KF Equity Holdings, LLC, a Georgia LLC of which Phillip is the sole member. When it acquired the equity stake in Centerstone, KF Equity Holdings executed a \$1 million promissory note in favor of Centerstone (the "Promissory Note.")

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<sup>1</sup> *Phillip v. Centerstone Linen Services, LLC*, C.A. No. 8712-ML (Oct. 1, 2013) (TRANSCRIPT) (hereinafter "Transc.") at 77-78.

In addition to his membership interest, Fillip became a manager of Centerstone and served as its CEO. On May 15, 2008, Fillip executed a Member Service Agreement (the “Employment Agreement”) governing the terms of his employment. The Employment Agreement set Fillip’s annual salary and the bonus he was eligible to earn, which amounted to 5% of Centerstone’s normalized EBITDA for the applicable calendar year. The Employment Agreement also provided that if Fillip resigned his position as CEO for “Good Reason,” or was terminated without cause, he was entitled to certain severance payments, along with a continuation of his benefits.

#### **B. Problems begin to develop between Fillip and the board of managers**

The honeymoon was not long lived. By 2010, problems had arisen between Fillip and Centerstone’s six-member board of managers (of which Fillip was one). The cause of those tensions is disputed and not relevant to this case, but appears to have centered around the search for a CFO for Centerstone, Fillip’s concerns regarding the company’s financial operations and direction, and the question of whether the company should be sold. Centerstone contends Fillip hired a CFO and covertly solicited offers to buy Centerstone, both without the knowledge or requisite approval of the board of managers. Fillip contends the board of managers failed to obtain sufficient capital to support the company’s operations and hired a CFO without consulting Fillip, which materially decreased Fillip’s responsibilities as CEO.

#### **C. Fillip’s resignation and the severance dispute**

Fillip resigned his position as CEO of Centerstone on October 5, 2012. He contends he resigned for “Good Reason” under the terms of the Employment Agreement

and therefore is entitled to a substantial severance payment. Centerstone disagrees that Phillip resigned for “Good Reason” and has refused to pay the severance he demanded. On December 4, 2012, Phillip filed a lawsuit in Georgia (the “Georgia Action”). In that lawsuit, Phillip argued that Centerstone had breached the Employment Agreement by failing to remit the severance payment. Phillip also sought to enjoin enforcement of the restrictive covenants in the Employment Agreement.

For a short time, it appeared that Phillip and Centerstone would resolve their disputes quickly. On January 14, 2013, the parties engaged in settlement negotiations and executed a term sheet. A month later, however, Centerstone refused to proceed with settlement on the basis that it had “discovered facts suggesting that Phillip had engaged in practices designed to manipulate Centerstone’s revenue.” In response to Phillip’s motion to enforce the settlement agreement, Centerstone argued Phillip had a fiduciary duty to Centerstone to disclose during settlement discussions that he had “manipulated” revenue, and that his failure to do so “fraudulently induced” Centerstone to enter into the settlement agreement.<sup>2</sup> The Georgia court ultimately refused to enforce the settlement agreement.

#### **D. Centerstone’s responds to the Georgia complaint**

Centerstone then answered Phillip’s complaint and filed a series of counterclaims against Phillip (the “Original Counterclaims”). The Original Counterclaims alleged Phillip had manipulated Centerstone’s revenues and EBIDTA “in an effort to obtain larger annual bonuses for himself,” modified the terms of repayment of the Promissory Note

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<sup>2</sup> Aff. of Phillip S. McKinney (hereinafter “McKinney Aff.”) ¶ 8.

without authorization, and attempted to covertly sell the company.<sup>3</sup> Centerstone alleged that these actions amounted to breaches of Fillip’s fiduciary duties and his Employment Agreement.

**E. Fillip seeks advancement and Centerstone amends its counterclaims**

Fillip quickly demanded that Centerstone advance Fillip’s attorneys’ fees and expenses for defending the Original Counterclaims, asserting that Article 3.7 of Centerstone’s Limited Liability Company Agreement (the “LLC Agreement”) provided advancement rights to Fillip. The language at issue provides:

3.7. INDEMNIFICATION. The Company shall indemnify, defend and hold harmless each Manager and Officer for all costs, losses, liabilities, and damages whatsoever paid or incurred by such Manager or Officer in the performance of his duties in such capacity, including, without limitation, reasonable attorney’s fees, expert witness and court costs, to the fullest extent provided or permitted by the [Delaware Limited Liability Company] Act or other applicable laws. Further, in the event fraud or bad faith claims are asserted against such Manager or Officer, the Company shall nonetheless bear all of the aforesaid expenses subject to the obligation of such Manager or Officer to repay all such expenses if they are finally determined to have committed such fraud or bad faith acts.

Centerstone quickly rejected Fillip’s advancement demand, but also indicated it would dismiss without prejudice those counterclaims that alleged Fillip had breached his fiduciary duties (the “Dismissed Counterclaims”). Centerstone indicated it would continue to pursue its counterclaims for breach of contract and for a declaratory judgment that the LLC Agreement barred Fillip from competing with Centerstone. Centerstone then filed an amended answer and counterclaim (the “Amended Counterclaims”).

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<sup>3</sup> Def.’s Verified Answer and Coutercl. in Ga. ¶ 1 ( Ex. D to Verified Compl. for Advancement).

Although the factual allegations supporting those Amended Counterclaims did not change substantially, Centerstone withdrew certain counts against Phillip and “clarified” the basis for other counts. There are now three counterclaims pending against Phillip in the Georgia Action.

The Amended Counterclaims continue to allege that Phillip (1) engaged in deceptive practices related to the company’s revenues, (2) manipulated Centerstone’s EBITDA to obtain larger bonuses for himself, (3) engaged in deceptive practices by modifying the terms of repayment of his note obligation to Centerstone without authorization, and (4) attempted to sell the Company without authorization from the other owners.<sup>4</sup> The Amended Counterclaims more specifically allege that Phillip engaged in a scheme to “‘put his digital foot on the scale’ and improperly inflate the Company’s revenues,” and that Phillip used subordinates to make “unjustified and improper adjustments to Centerstone’s EBITDA in order to overstate his bonus” from 2008 to 2012.<sup>5</sup> With respect to the Promissory Note, Centerstone alleges that: “[p]ursuant to the terms of the note, Phillip was obligated to pay \$1 million to Centerstone . . . . Rather than pay this amount to Centerstone as required by the note, Centerstone purported to apply part of his bonus to satisfy his note obligation.”<sup>6</sup> Those allegations, among others, form the basis for the three counts that remain in the Amended Counterclaims.

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<sup>4</sup> Def.’s Verified Answer and Am. Countercl. in Ga. (hereinafter “Ga. Am. Countercl.”) ¶ 1 (Ex. H to Verified Compl. for Advancement).

<sup>5</sup> *Id.* ¶¶ 8-9.

<sup>6</sup> *Id.* ¶ 18.

Count One alleges Fillip breached the Employment Agreement “by causing his annual bonus for the period 2008 through 2012 to be significantly overstated.” Count Two alleges Fillip breached the Promissory Note by modifying its terms without authorization. Count Three seeks a declaratory judgment that Article 14.13 of the LLC Agreement prohibits Fillip from entering into business opportunities that create a conflict of interest with Centerstone, including but not limited to soliciting customers and employees from Centerstone. Centerstone also asserted a number of affirmative defenses to Fillip’s claims in the Georgia Action, including that Fillip’s claims are barred by the doctrine of unclean hands and his own breaches of the Employment Agreement and the LLC Agreement (the “Affirmative Defenses”).<sup>7</sup>

When it withdrew the counterclaims that directly alleged Fillip had breached his fiduciary duties, Centerstone readily conceded it was doing so to avoid paying advancement. The Company initially stated it was withdrawing those counts without prejudice, arguing to the Georgia court that Centerstone intended to reassert those claims once it had further investigated the issues. In that way, Centerstone argued, “it could bring an early motion for summary judgment so as to avoid paying unnecessary legal fees on behalf of Mr. Fillip.”<sup>8</sup> Centerstone explained that discovery sought in connection with the Amended Counterclaims would allow the company to complete its investigation regarding Mr. Fillip’s alleged breaches of fiduciary duty, and that, although the fiduciary duty counterclaims had been withdrawn, Centerstone would be “looking at the same

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<sup>7</sup> *Id.* p. 14 (second and fourth defenses).

<sup>8</sup> Def.’s Opp’n to Pl.’s Expedited Mot. for Certificate of Immediate Review at 10-11 (Ex. I to Pl.’s Opening Br. in Support of Mot. for Summ. J.).



things with respect to the counterclaims that remain.”<sup>9</sup> It was not until September 25, 2013 that Centerstone changed course and announced it would dismiss the fiduciary duty counterclaims with prejudice.<sup>10</sup> As of the date of argument, disputes remained between the parties regarding how that dismissal properly could be accomplished.<sup>11</sup>

#### **F. The parties’ contentions in this action**

Fillip contends that Article 3.7 requires Centerstone to advance the fees and expenses he incurs in defense of the Amended Counterclaims and certain of the affirmative defenses, as well as the fees and expenses he previously incurred in connection with the motion to enforce the settlement agreement and the Dismissed Counterclaims. Centerstone adopts a two-pronged defense to Phillip’s advancement demand, arguing first that Article 3.7 only creates very narrow advancement rights, limited to claims for fraud and bad faith, which are not raised in the Georgia Action, and second that, even if Article 3.7 is interpreted to establish broad advancement rights, Phillip is not entitled to the advancement he seeks because none of the counterclaims or defenses relate to actions Phillip took in the “performance of his duties” as CEO or Manager of Centerstone. Centerstone therefore moved to dismiss Phillip’s complaint, while Phillip moved for summary judgment. These motions were briefed and argued simultaneously.

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<sup>9</sup> *Fillip v. Centerstone Linen Servs., LLC*, C.A. File No. 2012CV224517 (Ga. Super. Apr. 22, 2013) (TRANSCRIPT) at 14-15.

<sup>10</sup> Ltr. to Court from John DiTomo, Esq., dated Sept. 26, 2013, Ex. A.

<sup>11</sup> See Ltr. to Court from Marie M. Degnan, Esq., dated Sept. 30, 2013, Ex. A.

## ANALYSIS

Although Centerstone filed a motion to dismiss and Phillip filed a motion for summary judgment, the parties agree that this advancement action is ripe for decision on the record before the Court. That is, neither party contends that there are disputed issues of fact that require discovery or an evidentiary hearing to determine the scope of Phillip's advancement rights under the LLC Agreement.<sup>12</sup> Although the standards applicable to a motion to dismiss and a motion for summary judgment are substantially different, the standards do not factor into my decision in this case. Instead, as is often the case in matters of contract interpretation, the standards converge and the Court is left to interpret the unambiguous contract on the record before it. This Court routinely decides advancement cases on a paper record, which is an efficient and appropriate method to resolve disputes that almost always turn on the terms of the corporate instruments and the pleadings in the underlying litigation. This case is no different.

### **I. The Meaning of Article 3.7 of the LLC Agreement**

The parties first dispute the meaning of Article 3.7. Section 18-108 of the Delaware Limited Liability Company Act (the "LLC Act") gives contracting parties complete discretion in establishing the scope of indemnification and advancement rights for an LLC.<sup>13</sup> That Section provides:

Subject to such standards and restrictions, if any, as are set forth in its limited liability company agreement, a limited liability company may, and shall have the power to, indemnify and hold harmless any member or

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<sup>12</sup> See footnote 1, *supra*.

<sup>13</sup> See *Delphi Easter Partners Ltd. P'ship v. Spectacular Partners, Inc.*, 1993 WL 328079, at \*2 (Del. Ch. 1993) (interpreting Limited Partnership Act).

manager or other person from and against any and all claims and demands whatsoever.

In keeping with the policy of the LLC Act to maximize members' freedom to contract,<sup>14</sup> this Court interprets indemnification and advancement provisions in an LLC agreement like any other contract, ascertaining the parties' intent from the plain meaning of the terms they chose.<sup>15</sup>

Centerstone concedes Article 3.7 affords mandatory advancement rights to managers and officers of the company, but contends those advancement rights are narrowly circumscribed because only the second sentence of Article 3.7 refers to advancement and that sentence is limited to claims of fraud or bad faith. Centerstone bases this argument on the absence of the term "advance" or "advancement" in this first sentence. Fillip, on the other hand, argues the drafters used the word "defend" in the first sentence of Article 3.7 to establish a right to advancement, and that any arguable ambiguity attendant in the use of that word is clarified by the second sentence of Article 3.7.

Given the highly textual nature of the parties' dispute, I refer the reader back to the two sentences that comprise Article 3.7:

3.7. INDEMNIFICATION. The Company shall indemnify, defend and hold harmless each Manager and Officer for all costs, losses, liabilities, and damages whatsoever paid or incurred by such Manager or Officer in the performance of his duties in such capacity, including, without limitation,

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<sup>14</sup> See 6 Del. C. §18-1101.

<sup>15</sup> *Senior Tour Players 207 Mgmt Co. LLC v. Golftown 207 Holding Co. LLC*, 2004 WL 550743, at \*2 (Del. Ch. Mar. 10, 2004) (citing *Citadel Holding Corp. v. Roven*, 603 A.2d 818, 822 (Del. 1992)).

reasonable attorney's fees, expert witness and court costs, to the fullest extent provided or permitted by the [Delaware Limited Liability Company] Act or other applicable laws. Further, in the event fraud or bad faith claims are asserted against such Manager or Officer, the Company shall nonetheless bear all of the aforesaid expenses subject to the obligation of such Manager or Officer to repay all such expenses if they are finally determined to have committed such fraud or bad faith acts.

Delaware law is clear that contracts must be read as a whole to give effect to each term.<sup>16</sup> Our courts have been equally clear, however, in stating that Delaware's public policy favoring advancement does not trump basic principles of contract interpretation, and that corporations or alternative entities only will be required to advance litigation expenses if the governing instrument "expressly states the company's intention to mandate advancement."<sup>17</sup>

The first sentence of Article 3.7 requires Centerstone to "indemnify, defend, and hold harmless" managers and officers for costs incurred "in the performance of [their] duties." If the language in the first sentence excluded the word "defend," and referred only to Centerstone's obligation to "indemnify and hold harmless," it would be difficult to conclude that Article 3.7 provided broad advancement rights to managers and officers, because – as this Court previously held in *Majkowski v. American Imaging Management*

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<sup>16</sup> *Stockman v. Heartland Indus. Partners, L.P.*, 2009 WL 2096213, at \*6 (Del. Ch. July 14, 2009).

<sup>17</sup> *Majkowski v. Am. Imaging Mgmt Servs., LLC*, 913 A.2d 572, 593 (Del. Ch. 2006). *See also Advanced Mining Sys., Inc. v. Fricke*, 623 A.2d 82, 84 (Del. Ch. 1992) ("A by-law mandating advancement ... deprives the board of an opportunity to evaluate the important credit aspects of a decision with respect to advancing expenses. ... [T]he better policy, more consistent with the provisions of Section 145(e), is to require any such by-law expressly to state its intention to mandate the advancement ...").

*Services, LLC* – that phrase does not require a company to advance litigation expenses.<sup>18</sup> The question therefore turns on whether the addition of the word “defend” in Article 3.7 yields a different result.

Centerstone argues that the parties’ use of the word “defend” in the LLC Agreement does not create any additional rights apart from indemnification, relying in large part on this Court’s decision in *Senior Tour Players 207 Management Co. LLC v. Golftown 207 Holding Co. LLC*.<sup>19</sup> The broad reading of *Senior Tour Players* that Centerstone adopts is not supported by the Court’s reasoning in that case. In *Senior Tour Players*, the Court interpreted language stating that the company had no duty to “defend, indemnify and hold harmless” indemnified persons who were grossly negligent, engaged in certain willful misconduct, or were in material breach of the LLC agreement or their employment agreement.<sup>20</sup> There was no dispute between the parties that other language in the LLC agreement provided a mandatory right to advancement, and the Court declined to read the “defend, indemnify and hold harmless” language as conditioning advancement rights on a party’s ultimate right to indemnification.<sup>21</sup> The Court’s conclusion in that case did not turn on its interpretation of the word “defend,” and instead

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<sup>18</sup> 913 A.2d 572, 587-88 (Del. Ch. 2006). *See also Winshall v. Viacom Int’l Inc.*, 76 A.3d 808, 822 (Del. 2013) (“Under Delaware law, an ‘indemnify and hold harmless’ clause does not confer a right of advancement.”) (*citing Majkowski* with approval).

<sup>19</sup> 2004 WL 550743, at \*2-3 (Del. Ch. Mar. 10, 2004).

<sup>20</sup> *Id.* at \*2-3.

<sup>21</sup> *Id.* at \*2.

turned on the context of the LLC agreement at issue and the inherent difficulties in conditioning advancement on a right to indemnification.<sup>22</sup>

Both this Court and other courts have since held that the use of the word “defend” has meaning distinct from the phrase “indemnify and hold harmless,” and that the term “defend” often confers a right to advancement. In *Majkowski*, the Court suggested in *dicta* that, had the parties included “defend” in the phrase “indemnify and hold harmless,” the plaintiff “would have a stronger argument [that he was entitled to advancement] because the obligation to ‘defend’ comes closer to suggesting the active employment of attorneys and continual payment as the attorneys’ fees are incurred.”<sup>23</sup> More recently, the Delaware Supreme Court held in *Winshall v. Viacom International, Inc.* that when parties “intend to create separate duties to indemnify and to defend, they employ an ‘indemnify and defend against claims’ clause or similar language to that effect,” concluding that a contract’s reference to a duty to “indemnify” did not create a separate duty to defend.<sup>24</sup> The decision in *Winshall* strongly suggests a contract’s reference to a duty to defend means something other than an indemnity obligation and creates a duty to “pay for the outlays of defense on a current basis.”<sup>25</sup>

The better reading of the first sentence of Article 3.7, and the one consistent with *Majkowski* and *Winshall*, is that the reference to Centerstone’s duty to “defend” managers and officers created a mandatory right to advancement of litigation expenses. Whatever

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<sup>22</sup> *Id.*

<sup>23</sup> 913 A.2d at 589 n.39.

<sup>24</sup> *Winshall*, 76 A.3d at 820-21.

<sup>25</sup> *Id.* at 820 (citing *Lear Corp. v. Johnson Elec. Holdings Ltd*, 353 F.3d 580, 584 (7<sup>th</sup> Cir. 2003)).

ambiguity remains, however, is removed by the second sentence of Article 3.7. It is axiomatic that Article 3.7 must be read as a whole, “sensibly and completely,” and in context, in order to determine the drafters’ intent.<sup>26</sup> Were that maxim in doubt, the phrasing of the second sentence makes clear that it refers back to the first sentence of Article 3.7, using the words “further,” “nonetheless,” and “aforesaid” to clarify that the two sentences are interwoven. Contrary to Centerstone’s argument, the second sentence of Article 3.7 does not establish an advancement right. Instead, it clarifies that the advancement right conferred by the first sentence of Article 3.7 continues to apply even when a manager or officer faces claims of fraud or bad faith, thereby removing any doubt about the meaning of the word “defend.”

Centerstone unconvincingly contends that reading the second sentence of Article 3.7 as simply reinforcing the right established in the first sentence of that Article renders the second sentence superfluous, a result Delaware courts typically endeavor to avoid. Reading these two sentences in that way, however, does not render the second sentence meaningless. Rather, the second sentence directly states for the benefit of the contracting parties two important principles that otherwise are unstated, though arguably are implicit under settled law: (1) that advancement is required even if an official is accused of fraud or bad faith, and (2) that the advancement right would be subject to the official’s obligation to repay the amounts advanced if he was “finally determined to have committed such fraud or bad faith acts.” The fact that those principles may be implicit

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<sup>26</sup> See *Stockman v. Heartland Indus. Partners, L.P.*, 2009 WL 2096213, at \*6 (Del. Ch. July 14, 2009); *Weinstock v. Lazard Debt Recovery Gp, LLC*, 2003 WL 21843254, at \*4 (Del. Ch. Aug. 8, 2003).

under settled law does not make the second sentence meaningless. Instead, it clarifies for the parties the parameters of the advancement right, presumably based on the reasonable assumption that the parties to the agreement might not be intimately familiar with Delaware advancement law.

In addition, Centerstone's position is difficult to embrace because it would require me to conclude that the parties intended to limit advancement to those circumstances in which an official was accused of fraud or bad faith, eschewing advancement for the more mundane cases where companies typically do not balk at advancing expenses.<sup>27</sup> Of course, a company is free to draft its agreement in such a counterintuitive way, but I cannot conclude that such a reading of Article 3.7 would be a sensible interpretation of the parties' agreement in this case.

Centerstone also vaguely raises an argument that, even if the first sentence of Article 3.7 creates a mandatory right to advancement, that advancement right is limited by the language referring to costs incurred by a manager or officer "in the performance of his duties in such capacity." Centerstone suggests that, by this language, the drafters adopted a narrower standard than that applicable to corporations. Section 145 of the Delaware General Corporation Law gives corporations the power to provide indemnification and advancement to "any person who was or is a party ... to any ...

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<sup>27</sup> Experience teaches that companies rarely hesitate when officials face third party claims of negligence or other, less egregious conduct. Instead, it is when officials are accused of willful misconduct that a company more often begins searching for ways to avoid advancement. Although certainly possible, it would be rather unusual for a company to indicate a willingness to provide advancement *only* when an official faces claims of fraud or bad faith, or for an official to agree to such a limitation.



action ... *by reason of the fact* that the person is or was a director, officer, employee or agent of the corporation.”<sup>28</sup> Interpreting that language, the Delaware courts have held “if there is a nexus or causal connection between any of the underlying proceedings ... and one’s official capacity, those proceedings are ‘by reason of the fact’ that one was a corporate officer.”<sup>29</sup> If the corporate powers were used or necessary for the commission of the alleged misconduct, that nexus is established.<sup>30</sup> The language in Section 145 has been interpreted broadly to include all actions brought against an officer or director “for wrongdoing that he committed in his official capacity,” and for all misconduct that allegedly occurred “in the course of performing his day-to-day managerial duties.”<sup>31</sup>

Although Centerstone stated several times that this “in the performance of his duties” language is “far more stringent” than the “by reason of the fact” language contained in 8 *Del. C.* § 145,<sup>32</sup> Centerstone does not offer any principled analysis as to why those phrases offer distinct standards, other than an implicit *ipse dixit* suggestion that, because the parties used different phraseology they must have intended a different, narrower meaning.<sup>33</sup> I am therefore left to guess at what Centerstone thinks this language means. My reluctance toward divination aside,<sup>34</sup> I cannot discern what distinction Centerstone would have me draw between the “by reason of the fact” language in Section

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<sup>28</sup> 8 *Del. C.* § 145(a), (e).

<sup>29</sup> *Homestore v. Tafeen*, 888 A.2d 204, 214 (Del. 2005).

<sup>30</sup> *Bernstein v. TractManager, Inc.*, 953 A.2d 1003, 1011 (Del. Ch. 2007).

<sup>31</sup> *Reddy v. Electronic Data Sys. Corp.*, 2002 WL 1358761, at \*6 (Del. Ch. June 18, 2002).

<sup>32</sup> Def.’s Reply Br. in Support of Def.’s Mot. to Dismiss (hereinafter “Def.’s Reply Br.”) at 7; Def.’s Answering Br. in Opp’n. To Pl.’s Mot. for Summ. J. (hereinafter “Def.’s Answering Br.”) at 15.

<sup>33</sup> See Transc. at 54.

<sup>34</sup> See Leviticus 19:26.

145 and the “in the performance of his duties in such capacity” language in the LLC Agreement. I do not understand Centerstone to argue that the reference to “duties” refers to a manager’s or officer’s fiduciary duties, nor would such a distinction be workable in the advancement context, because it likely would require the company or a court to determine whether the manager or officer ultimately was entitled to indemnification. Neither party contends that this language is ambiguous, which might require the Court to consider extrinsic evidence, and I do not believe any such ambiguity exists. The phrase “in the performance of his duties in such capacity” must be considered with the language in Article 3.7 that the company shall indemnify, defend, and hold managers and officers harmless “to the fullest extent provided or permitted by the [LLC] Act.” The LLC Act permits parties to an operating agreement to provide indemnification and advancement rights for “any and all claims and demands whatsoever.”<sup>35</sup> In addition, the drafters’ use of the “in such capacity” language is consistent with the interpretation of Section 145 as encompassing claims of wrongdoing committed by an officer in his official capacity and in the performance his day-to-day duties.<sup>36</sup> Thus, the language used in Article 3.7 and its reference to the broad authority to indemnify accorded by the LLC Act does not support a conclusion that the drafters intended the indemnification and advancement rights to be more narrow than those afforded by Section 145’s “by reason of the fact” standard.

I therefore conclude that, by its terms, Article 3.7 extends mandatory advancement rights to any manager or officer of Centerstone who incurs costs or expenses by reason of

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<sup>35</sup> 6 *Del. C.* § 18-108.

<sup>36</sup> See footnote 31, *supra*.

his position as manager or officer of the company. The task now turns to applying that advancement right in the context of the Georgia Action.

## **II. Advancement in the Georgia Action**

For clarity, I divided the parties' dispute regarding Phillip's right to advancement in the Georgia Action into four categories: (a) the Amended Counterclaims, (b) the Dismissed Counterclaims, (c) the Affirmative Defenses, and (d) the motion to enforce the settlement agreement. Although they are somewhat interrelated, I will address each category in turn.

### **A. The Amended Counterclaims**

To review, there are three counterclaims currently pending against Phillip in the Georgia Action. Count I alleges a breach of contract claim relating to Phillip's bonus, Count II alleges a breach of contract claim relating to the Promissory Note, and Count III seeks a declaratory judgment regarding Article 14.13 of the Operating Agreement. Phillip contends that he is entitled to advancement for Counts I and II, and may be entitled to advancement for Count III. Centerstone, on the other hand, contends that the "true nature" of the Amended Counterclaims is only to assert breach of contract and declaratory judgment claims that are "based on specific, limited, personal contractual obligations that are the result of the parties' arms-length negotiations," and are not subject to advancement, even if, as I already concluded, Article 3.7 creates broad mandatory advancement rights for managers and officers.

Centerstone is correct that the Amended Counterclaims do not directly allege that Phillip breached his fiduciary duties, because Centerstone specifically dismissed those

fiduciary duty counts in an attempt to avoid its advancement obligations. The fact that the remaining counterclaims do not include a count for breach of fiduciary duty, however, is not dispositive of the issue at hand. As it has on several occasions in the past, this Court will elevate the substance of the pleadings over the form and evaluate the essence of the allegations in each count, rather than placing undue emphasis on the labeling of those counts.<sup>37</sup>

Centerstone contends that this inquiry should lead me to conclude that the Amended Counterclaims relate solely to Phillip's personal, contractual obligations, and do not fall within the "performance of his duties" language under Article 3.7. In support of that argument, Centerstone points to the Delaware Supreme Court's decision in *Stifel Financial Corp. v. Cochran*,<sup>38</sup> and this Court's decision in *Weaver v. Zenimax Media, Inc.*<sup>39</sup>

In *Cochran*, the Delaware Supreme Court addressed the indemnification rights of an officer of a subsidiary corporation who served in that capacity at the request of the parent corporation. After the officer was terminated, he refused to repay excessive compensation and the balance of a promissory note, as required by the terms of his employment agreement. The subsidiary therefore instituted arbitration proceedings to recover those amounts.<sup>40</sup> The arbitrators ruled in favor of the subsidiary on the compensation claim and promissory note claim, and ordered the officer to repay

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<sup>37</sup> See *Brown v. LiveOps, Inc.*, 903 A.2d 324, 329 (Del. 2006); *Weaver v. Zenimax Media, Inc.*, 2004 WL 243163, at \*4 (Del. Ch. Jan. 30, 2004).

<sup>38</sup> 809 A.2d 555 (Del. 2002).

<sup>39</sup> 2004 WL 243163 (Del. Ch. Jan. 30, 2004).

<sup>40</sup> 809 A.2d at 557.

approximately \$1.2 million. The arbitration also involved a claim that the officer breached his fiduciary duties. The officer prevailed on that claim and the parent agreed to indemnify him for litigation expenses associated with the breach of duty claim. When the officer sought indemnification from the parent for the judgment and litigation expenses associated with the compensation claim and promissory note, the Court of Chancery rejected the officer's claim for indemnification and the Supreme Court affirmed, reasoning:

We agree that the claims litigated in the arbitration action were properly characterized as personal, not directed at [the officer] in his 'official capacity' as an officer and director of [the subsidiary]. ... [The subsidiary] based the [c]ompensation [c]laim, the [p]romissory [n]ote [c]laim, and the [n]on-[c]ompete [c]laim on the employment contract [the officer] entered into with the company. Although [the officer's] termination is the event that triggered the relevant provisions of the employment contract, [the officer's] decision to breach the contract was entirely a personal one, pursued for his sole benefit. *Further, the underlying accusations against [the officer] were considered by the arbitrators, but found to be irrelevant to the simple dispute before them – whether [the officer] breached his employment agreement.*<sup>41</sup>

This Court reached a similar decision in *Weaver*, concluding that a corporation's claims that an officer breached his employment agreement by taking excessive vacation time and receiving improper travel reimbursements were quintessentially personal claims arising out of the officer's employment contract and were not brought "by reason of the fact" that he was an officer or director of the corporation.<sup>42</sup>

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<sup>41</sup> *Cochran*, 809 A.2d at 562 (emphasis added).

<sup>42</sup> *Weaver*, 2004 WL 243163, at \*3-4.

Centerstone argues that *Cochran* stands for the proposition that breach of contract claims based on an employment agreement or promissory note are personal in nature and cannot give rise to advancement rights. Several features of *Cochran* distinguish it from this case and from the broad application Centerstone's position would require.

First, *Cochran* was an indemnification case, rather than an advancement action. Although that distinction is not determinative, it is important, because the reasoning in *Cochran* rested in part on the fact that requiring a corporation to indemnify an official for a judgment the official owes the corporation would "render the officer's duty to perform his side of the contract in many respects illusory."<sup>43</sup> The same concerns do not inure in an advancement case, because a person who receives advancement always must repay those funds in the event he is not ultimately entitled to indemnification. Because of this important distinction between indemnification and advancement, if a "*Cochran* argument" is to succeed in the advancement context, the claim at issue must plainly involve a specific and limited contractual obligation that bears no causal connection with the person's official duties.<sup>44</sup>

Second, Centerstone's expansive reading of *Cochran* is inconsistent with advancement law generally and with several decisions of this Court specifically. For example, an argument very similar to Centerstone's was considered and rejected by this

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<sup>43</sup> *Cochran*, 809 A.2d at 562 (quoting *Cochran v. Stifel Fin. Corp.*, 2000 WL 1847676 (Del. Ch. Dec. 13, 2000)). See also *Paolino v. Mace Security Int'l, Inc.*, 985 A.2d 392, 406 (Del. Ch. 2009) ("*Cochran*'s holding that a personal contractual obligation lacked the necessary nexus rested on both the specificity of the contractual obligation and the circularity of the covered person being obligated to make the called-for payment, then obtaining it back through indemnification.").

<sup>44</sup> *Paolino*, 985 A.2d at 407.

Court in *Reddy v. Electronic Data Systems Corp.*<sup>45</sup> The underlying litigation in *Reddy* involved allegations that a former officer, who sold his company to the defendant corporation and then took over the division of the corporation that included his former company, fraudulently inflated the performance of that division in order to increase the size of his bonus and the earn-out he would receive under the sales agreement. The corporation did not bring claims against the former official for breach of fiduciary duty, but instead alleged claims for negligence, breach of contract, and fraud. The *Reddy* court concluded that, although the corporation did not specifically allege that the former officer breached his fiduciary duties, the claims pled allegations of fiduciary misconduct and the officer was entitled to advancement because all the claims alleged misconduct that involved actions the officer took “on the job in the course of performing his day-to-day managerial duties.”<sup>46</sup> This Court also rejected the corporation’s argument that *Cochran* barred advancement for the breach of contract claims against the officer, finding the alleged contractual breaches were based on the same allegations of fiduciary misconduct that supported the other claims. The *Reddy* court explained:

To permit EDS to escape its advancement duties on this hyper-technical ground would invite abuse. Under this rubric, a corporation could sue a faithless officer or employee only under her employment contract. In defending an advancement suit, a corporation would then argue that the employee's improper on-the-job acts were simply breaches of an implied covenant to serve the corporation faithfully and honestly, and that the contractual claims against her did not implicate her right to advancement. I am reluctant to issue a decision creating this incentive, because it seems contrary to the legislative intent behind § 145, as recognized by our

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<sup>45</sup> 2002 WL 1358761 (Del. Ch. Jun. 18, 2002).

<sup>46</sup> *Id.* at \*6.

Supreme Court. *Rather, because EDS has premised its contractual claims entirely on allegedly improper actions taken by Reddy in his official capacity, I conclude that EDS has implicated the protections promised in its own bylaws. Therefore, it must advance funds to Reddy.*<sup>47</sup>

As in *Reddy*, Centerstone’s claims against Fillip, although styled as breach of contract claims, are premised entirely on the proposition that Fillip used his position as CEO to engage in certain conduct that Centerstone contends resulted in a breach of the Employment Agreement and the Promissory Note. Count I is based on Centerstone’s allegations that Fillip – either directly or through instructions to his subordinates – falsely inflated Centerstone’s revenues and EBITDA to inflate his compensation. The fact that Fillip’s compensation was set by the Employment Agreement does not make this conduct a “purely personal” claim based solely on his contractual obligations. Instead, the contractual claim in Count I is based on allegations that Fillip took improper actions in his official capacity as CEO that resulted in overpayment of his compensation.<sup>48</sup> Expenses Fillip incurs in defense of these allegations fall squarely within the language of Article 3.7, which provides advancement for losses, liabilities, and damages incurred in the performance of an officer’s duties in such capacity.

Similarly, Count II asserts a breach of contract claim against Fillip based on Centerstone’s allegation that he used his position as CEO to modify the terms of the Promissory Note without Centerstone’s knowledge or consent. Under Centerstone’s theory, rather than paying the note directly, Fillip directed that part of his bonus should

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<sup>47</sup> *Id.* at \*8 (emphasis added).

<sup>48</sup> See Ga. Am. Countercl. ¶ 23 (“Fillip breached the Employment Agreement by causing his annual bonus for the period 2008 through 2012 to be significantly overstated.”).



be applied to reduce the obligation. Frankly, the “contractual” nature of this claim against Phillip is somewhat amorphous: the Promissory Note is a contract between Centerstone and KF Equity Holdings, and it is unclear to me how Phillip’s actions in this regard could have amounted to a breach of a contract to which he was not a party. In fact, in the Original Counterclaims, this count was pled solely as a breach of fiduciary duty claim. Nonetheless, not being an expert on Georgia law, I will accept at face value that this is a valid breach of contract claim. Resting as it does on allegations that Phillip committed this alleged misconduct in his official capacity as CEO, Count II nonetheless is a claim for which Phillip is entitled to advancement. Indeed, it is impossible to imagine how Phillip could have taken these alleged actions were it not for his position as CEO.

Phillip’s entitlement to advancement for Count III is, unfortunately, less clear. Although Phillip maintained throughout the briefing on the pending motions that he was entitled to advancement for all the Amended Counterclaims, during argument his counsel candidly acknowledged that Phillip’s entitlement to advancement for Count III was uncertain.<sup>49</sup> Counsel conceded that if Centerstone’s claim was strictly one seeking an interpretation of the contract, the claim was not subject to advancement, but that if Centerstone was contending Phillip, by his conduct as an officer, had breached Article 14.13, he was entitled to advancement.<sup>50</sup> At the time of argument, Centerstone had not completed contention interrogatories directed toward clarifying the basis for Count III.<sup>51</sup> If the parties are unable to negotiate a resolution regarding Phillip’s entitlement to

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<sup>49</sup> Transc. at 32-35.

<sup>50</sup> Transc. at 34.

<sup>51</sup> Transc. at 34.

advancement for Count III, based on the foregoing analysis of the scope of Article 3.7 and the discovery responses in the Georgia Action, they should submit brief supplemental memoranda directed toward the discreet issue of whether Count III is subject to advancement.

### **B. The Dismissed Counterclaims**

Argument on the pending motions also served to clarify Centerstone's position regarding the Dismissed Counterclaims. Although Centerstone's written submissions suggested it was taking the position that Phillip was not entitled to advancement for the Dismissed Counterclaims because they were not presently pending against him, during argument Centerstone conceded that Phillip was entitled to advancement for any litigation expenses incurred between the time Centerstone filed the Original Counterclaims and the time it notified Phillip that it would dismiss those claims directly alleging Phillip breached his fiduciary duties.<sup>52</sup> Centerstone argued that once it notified Phillip of its intent to dismiss the claims, however, those claims were no longer "asserted" against him, and therefore his right to advancement ceased.

This argument is unpersuasive for a number of reasons. First, it rests on Centerstone's narrow reading of Article 3.7, *i.e.*, that Article 3.7 only provides advancement for fraud and bad faith claims, and only those claims that "are asserted" against an officer or manager. Having concluded that the advancement rights conferred by Article 3.7 are established in the first sentence of that article, Centerstone's focus on the "are asserted" language in the second sentence of Article 3.7 carries little weight.

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<sup>52</sup> Transc. at 68-71.

Second, even after Centerstone announced its intent to dismiss the Original Counterclaims without prejudice, it continued to maintain that it would reassert those claims at a later time, and that the discovery it was seeking in the Georgia Action would allow it to investigate those claims and later reassert them against Phillip, with the goal of filing an early, dispositive motion and minimizing the amount of advancement to which Phillip would be entitled. Phillip's counsel therefore understandably continued to take the position that Phillip was entitled to advancement for the Dismissed Counterclaims, an argument that seemingly prevailed when Centerstone later agreed to dismiss those counterclaims with prejudice. Phillip then incurred additional litigation expenses regarding the proper procedure for accomplishing that "with prejudice" dismissal. All of those efforts were expenses incurred in defense of claims Centerstone brought against Phillip for actions he took in his official capacity, and are properly subject to advancement.

### **C. The Affirmative Defenses**

In addition to the three Amended Counterclaims it is asserting against Phillip, Centerstone also pleads a number of affirmative defenses to Phillip's claims in the Georgia Action. Again, the basis for those affirmative defenses is not fully developed, but Phillip contends, at a minimum, that he is entitled to advancement for expenses relating to Centerstone's second affirmative defense, which asserts that Phillip's own breaches of the Employment Agreement and the LLC Agreement bar the relief he seeks, and its fourth affirmative defense, which is based on the doctrine of unclean hands.

Centerstone readily concedes that many of the allegations in the Amended Counterclaims that relate to Phillip's alleged misconduct and faithless behavior were

offered in support of its affirmative defenses,<sup>53</sup> but nevertheless argues that Phillip is not entitled to advancement for expenses relating to the affirmative defenses because those are “defenses,” and Phillip only is entitled to advancement for “claims.”<sup>54</sup> Again, Centerstone’s effort to limit its advancement obligation leads to a reading of Article 3.7 that is at odds with the contractual language. This argument is based on Centerstone’s narrow reading of Article 3.7, which I previously rejected. The first sentence of Article 3.7, which confers mandatory advancement rights on officers and directors, applies to all “costs, losses, liabilities, and damages whatsoever paid or incurred” by an officer or director. Nowhere is this language limited to expenses incurred in defense of “claims.”

The question of whether a manager or officer is entitled to advancement for affirmative defenses *asserted against him* is different from previous cases in which this Court concluded that a corporate official is entitled to advancement for certain affirmative defenses the official asserts in defense of claims.<sup>55</sup> Those cases therefore are of little help in analyzing this issue. Rather, the conclusion turns on the text of Article 3.7 and the policy underlying advancement. Article 3.7 defines Centerstone’s advancement obligation to include “all costs, losses, liabilities, and damages whatsoever paid or incurred ... in the performance of [a manager’s or officer’s] duties in such capacity ... to the fullest extent permitted by the [LLC Act].” As previously discussed, the LLC Act permits companies to indemnify and advance a person “from and against

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<sup>53</sup> See Def.’s Reply Br. at 16; Def.’s Answering Br. at 7, Transc. at 71-74.

<sup>54</sup> Transc. at 63-64.

<sup>55</sup> See *Citadel Holding Corp. v. Roven*, 603 A.2d 818, 824 (Del. 1992); *Zaman v. Amedeo Holdings, Inc.*, 2008 WL 2168397, at \*35 (Del. Ch. May 23, 2008).

any and all claims and demands whatsoever.” It is difficult to conceive of broader language than that contained in Section 18-108, and Article 3.7’s adoption of that standard makes its scope equally broad. Centerstone concedes that its second and fourth affirmative defenses directly implicate Phillip’s performance of his duties, and Phillip therefore is entitled to advancement for expenses incurred in connection with those affirmative defenses.

The policy behind advancement lends support to that conclusion. Indemnification and the subsidiary concept of advancement are intended to encourage persons to serve in a company, “secure in the knowledge that expenses incurred by them in upholding their honesty and integrity will be borne by the corporation they serve.”<sup>56</sup> In resisting the affirmative defenses that accuse him of egregious misconduct when serving as Centerstone’s CEO, Phillip unquestionably seeks to uphold his reputation. Although Phillip may not face monetary liability if Centerstone prevails on these affirmative defenses, a judgment that he breached his fiduciary duties will have substantial implications for Phillip and his future employment prospects. This is precisely the consequence advancement is intended to help an official avoid. Because advancement relating to the Affirmative Defenses is consistent with both the text of Article 3.7 and the policy supporting advancement, Centerstone must advance Phillip’s litigation expenses related to those defenses.

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<sup>56</sup> *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339, 344 (Del. 1983) (quoting E. Folk, *The Delaware General Corporation Law* 98 (1972)). *See also Constantini v. Swiss Farm Stores Acquisition LLC*, 2013 WL 4758228, at \* 1 (Del. Ch. Sept. 5, 2013) (“The same policy reasons supporting indemnification for corporate actors apply to actors for other entities, including LLCs.”).

#### **D. The Motion to Enforce the Settlement Agreement**

Centerstone offered very little argument regarding Fillip's entitlement to reimbursement for the motion to enforce the settlement agreement, other than to rely again on its position that Fillip only is entitled to advancement for "claims" and therefore is not entitled to advancement for Centerstone's defense of Fillip's motion. Centerstone readily concedes, however, that its defense of the motion to enforce was based, at least in part, on its argument that any settlement agreement was unenforceable because Fillip breached his fiduciary duties to Centerstone and fraudulently induced Centerstone to settle the Georgia Action before Centerstone discovered "Fillip's manipulation of the Company's revenue and profitability."<sup>57</sup> Centerstone asserts that granting Fillip advancement for expenses incurred in connection with Centerstone's defense of the motion would render the company unable to defend itself.<sup>58</sup>

Having already concluded that Centerstone is obligated to advance Fillip for the Affirmative Defenses, and having already rejected Centerstone's argument that its advancement obligation is limited to "claims," there is little more to say regarding Centerstone's position, except that the company must advance Fillip's litigation expenses for the motion to enforce to the extent those fees are related to Centerstone's argument about fraudulent inducement. It appears that the motion to enforce also related to a

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<sup>57</sup> Def.'s Answering Br. at 8-9.

<sup>58</sup> *Id.* at 19; Transc. at 41.

separate argument about whether the parties agreed to all material terms,<sup>59</sup> and expenses related to that dispute are not properly the subject of advancement.

### **III. Apportioning Fees in the Georgia Action**

Having concluded that Phillip is entitled to advancement for Counts I and II of the Amended Counterclaims, the second and fourth affirmative defenses, the Dismissed Counterclaims, and a portion of the motion to enforce the settlement agreement, I am left to determine the amount to which Phillip is entitled. Although Phillip submitted affidavits from his Georgia attorneys estimating that Phillip had incurred expenses of more than \$260,000 in the Georgia Action relating to claims subject to advancement,<sup>60</sup> those affidavits did not contain the level of detail necessary for either Centerstone or the Court to evaluate the reasonableness of that calculation. My ruling also may have changed that figure, and additional fees likely have been incurred since that affidavit was submitted.

Given the incomplete record on this point, I invite the parties to confer and attempt to negotiate a reasonable method for apportioning fees in the Georgia Action between those claims or defenses that are subject to advancement and those that are not. Such an agreement should address fees already incurred and a method for submitting future fee demands and resolving any disagreements with respect to such demands. If the parties are unable to agree, additional motion practice will be necessary, in which case the

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<sup>59</sup> Aff. of Samuel M. Matchett ¶ 6 (Ex. D to Def.'s Answering Br.).

<sup>60</sup> McKinney Aff. ¶ 6.

parties' submissions should contain the level of detail and information discussed by the Court in *Danenberg v. Fittracks, Inc.*<sup>61</sup>

#### **IV. Fees on Fees**

Centerstone does not dispute that, to the extent he is successful in this action, Fillip is entitled to indemnification, or “fees on fees,” incurred in connection with enforcing his advancement right. Because he was almost entirely successful in prosecuting this action, and because Centerstone has not offered any contrary argument, I conclude that Fillip is entitled to reimbursement of 90% of his expenses incurred in this proceeding.<sup>62</sup> That figure may increase if Fillip convinces Centerstone or this Court that Count III of the Amended Counterclaims requires advancement.

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<sup>61</sup> 58 A.2d 991 (Del. Ch. 2012).

<sup>62</sup> See *Zaman v. Amedeo Holdings, Inc.*, 2008 WL 2168397 at \*39 (Del. Ch. May 23, 2008) (explaining that an award of 80% of the plaintiffs' fees is a measured way to reflect the policy goal that “corporate officials do not achieve a pyrrhic victory in § 145 cases whereby what they win is largely offset by their costs of prosecution ... while giving the defendants credit for the fact that the [plaintiffs] did not attain complete success.”). Here, the parties' dispute involved two main issues: (1) the interpretation of Article 3.7, and (2) the application of Article 3.7 to the Georgia Action. The parties spent approximately equal amounts of time briefing and arguing those issues, and the fees incurred on those disputes also likely were roughly evenly split between the two. Fillip was entirely successful on the first issue. The second issue comprised four sub-issues: (i) the Amended Counterclaims, (ii) the Dismissed Counterclaims, (iii) the Affirmative Defenses, and (iv) the motion to enforce. He largely was successful on those sub-issues, aside from advancement for Count III and the motion to enforce, where he was partially successful. Using rough math and apportioning time equally among those sub-issues, I estimate that the parties spent 4% of their time on Count III ( $50\% \div 4 \text{ sub-issues} \div 3 \text{ Counts}$ ) and 12% of their time on the motion to enforce, although I expect that latter figure is overly generous. Because Fillip was partially successful on the motion to enforce, he should receive half of the fees associated with that time, or 6% of the total fees incurred in this action. Reducing the total fees by 4% for Count III and 6% for the motion to enforce leads to the 90% “fees on fees” figure. See *Fasciana v. Electronic Data Systems Corp.*, 829 A.3d 178, 188 (Del. Ch. 2003) (The Court awarded the plaintiff one-third of his fees on fees because he was successful on one of the three claims he raised.)



## V. Interest

In Delaware, prejudgment interest is awarded as a matter of right and should be computed from the date payment is due.<sup>63</sup> Interest typically is computed from the date an officer submitted a request for payment that “quantified the demand for advancement,” because, in a contractual settling, prejudgment interest does not accrue until the defendant has failed to live up to its obligations.<sup>64</sup> Where, however, the company has frustrated the officer’s ability to submit a detailed demand by unequivocally refusing an initial demand for advancement and failing to indicate where invoices could be sent, this Court has awarded interest beginning ten days after the date the officer submitted his initial demand for advancement.<sup>65</sup> Phillip made his initial advancement demand on April 8, 2013, in which he requested advancement and asked Centerstone’s counsel to identify where invoices should be directed.<sup>66</sup> Centerstone unequivocally denied that Phillip was entitled to any advancement and failed to identify where a specific demand and invoices should be sent.<sup>67</sup> Phillip therefore is entitled to prejudgment interest beginning April 18, 2013 for all expenses incurred before that date, and to prejudgment interest on expenses incurred after April 8, 2013 from the date such expenses were paid. Phillip is entitled to post-judgment interest, compounded quarterly, at the legal rate under 6 *Del. C.* § 2301.<sup>68</sup>

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<sup>63</sup> *Citadel Holding Corp. v. Roven*, 603 A.2d 818, 826 (Del. 1992).

<sup>64</sup> *Underbrink v. Warrior Energy Servs. Corp.*, 2008 WL 2262316, at \*19 (Del. Ch. May 30, 2008).

<sup>65</sup> *Citrin v. Int’l Airport Centers LLC*, 922 A.2d 1164, 1168 (Del. Ch. 2006).

<sup>66</sup> Pl.’s Opening Br. in Support of Mot. for Summ. J. Ex. F.

<sup>67</sup> *Id.* Ex. G.

<sup>68</sup> *Underbrink*, 2008 WL 2262316, at \* 19.

## CONCLUSION

For the foregoing reasons, I recommend the Court find Phillip is entitled to advancement for: (1) Counts I and II of the Amended Counterclaims, (2) the Dismissed Counterclaims, (3) the second and fourth affirmative defenses, and (4) the portion of the motion to enforce relating to Phillip's alleged breach of fiduciary duties and fraudulent inducement. This is my final report and exceptions may be taken in accordance with Rule 144.

Respectfully submitted,

*/s/ Abigail M. LeGrow*  
Master in Chancery